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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937—No. 48

MUNRO L. LYETH,

Petitioner,

v.

JAMES J. HOEY, Collector of Internal Revenue of the United States for the Second District of the State of New York.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

J. M. RICHARDSON LYETH,
WILL R. GREGG,
ALLIN H. PIERCE,
Counsel for Petitioner.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Munro L. Lyeth, respectfully shows to the Court as follows:

STATEMENT

This is a petition for a writ of certiorari to review a decision of the United States Circuit Court of Appeals for the Second Circuit reversing a judgment entered in the District Court for the Southern District of New York against the Collector for $65,005.68 with interest and costs. A written opinion (R. 203-209) and a concurring opinion by Judge Augustus N. Hand (R. 210-212) were handed down and the order for mandate was filed on April 18, 1938 (R. 213).

Petitioner sued to recover additional income taxes for the year 1933 paid pursuant to an additional assessment based upon the receipt by him from the executors of his grandmother's estate of certain property pursuant to an agreement compromising objections to the probate of the will. The Collector filed an answer and petitioner moved for summary judgment under Rule 113 of the New York Rules of Civil Practice upon the pleadings and upon affidavits. Judge Coxe made an order granting the motion (R. 188-190) and judgment for the petitioner was entered thereon (R. 190-191). The Circuit Court of Appeals reversed the judgment (R. 213).

The Facts

The facts are not in dispute.

Petitioner's grandmother, Mary B. Longyear, died a resident of Massachusetts leaving an estate initially inventoried at more than $3,000,000. By her will the decedent bequeathed to her four surviving children and the petitioner and his brother, children of a deceased daughter, comparatively trifling legacies, and she bequeathed to an alleged charitable trust the entire residue (R. 90, 91).

The heirs objected to the probate of the will upon the grounds of lack of testamentary capacity and undue influence. The heirs moved for an order framing jury issues (R. 92). Under Massachusetts law a probate judge in granting such a motion must find that there was a "genuine question of fact supported by evidence of such substantial nature as to afford ground for reasonable expectation of a result favorable to the party requesting the framing of issues." *Smith* v. *Patterson,* 286 Mass. 356 (1934) (R. 93). After hearing offers of proof from counsel for pro-

ponents of the will and counsel for the heirs, the Probate Judge entered an order framing jury issues (R. 92).

Thereafter a compromise agreement was entered into which provided in substance that the specific and pecuniary bequests to individuals be enforced, but that the residuary bequest to the alleged charitable trust be disregarded and the net residue of the estate be divided one half to the said charitable trust and one half to the heirs. The compromise agreement was approved by the Massachusetts Probate Court pursuant to a Massachusetts statute and a decree was entered admitting the will to probate, issuing letters testamentary to the executors named therein, and directing said executors to "administer the estate of said deceased in accordance with the terms of said will and said agreement of compromise" (R. 96, 97, 62, 63, 24-50).

The executors, pursuant to said order, transferred to an assignee of the petitioner a certificate of deposit representing shares of corporations owned by the decedent prior to her death (R. 98). The Commissioner valued this distributable share of the petitioner at $141,484.63 and treated the whole amount as taxable income for the year in which it was received (R. 12-15). Petitioner paid the amount of the deficiency assessed thereon and brought this suit against the Collector to recover the amount paid.

Questions Involved

The questions presented in this case are:

(1) Is a distribution from a decedent's estate made to an heir by the executors pursuant to an order of the Probate Court, following the compromise of a will contest in that court, income under the Sixteenth Amendment of the Constitution of the United States?

(2) If such a distribution made in the year 1933 is income, is it exempt from taxation under Section 22 (b) (3) of the Revenue Act of 1932 which exempts "The value of property acquired by gift, bequest, devise, or inheritance * * *"?

(3) If a compromise of litigation is regarded as a sale or exchange of property, must the taxpayer, in order to establish his basis for determining gain or loss, prove the value of his chance of success by producing the evidence he would have introduced at the trial of the litigation compromised?

(4) Are the federal courts controlled by the shifting theories of local laws applied in state inheritance tax cases, regarding the manner of transmission of a decedent's property where the ownership of the property is not in dispute?

Reasons for Granting Writ

(1) The decision below is in conflict with the decision of the United States Circuit Court of Appeals for the Fourth Circuit in *Magruder* v. *Segebade*, 94 Fed. (2d) 177 (January 4, 1938) in which that Court expressly approved and followed the decision of District Judge Coxe herein. The Solicitor General decided not to apply for a writ of certiorari in said *Magruder* v. *Segebade* and the time within which to make such application has expired.

(2) The Court below has decided that a claim which if successfully prosecuted to judgment would not be productive of taxable income, produces taxable income if it is compromised. A considerable number of cases are pending in the Bureau of Internal Revenue, the Board of Tax Appeals and the Courts, involving this question and several are being held in abeyance awaiting final decision in this case. A list of the pending cases is contained in Appendix A.

(3) The decision below is of far-reaching importance in that it will affect the income tax liability of parties to every compromise of a disputed claim of a capital nature.

WHEREFORE your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and send to this Court on a day designated for its review and determination a full and complete transcript of the record and full proceedings in said Circuit Court of Appeals had in the case numbered 211 and entitled "*Munro L. Lyeth,* Plaintiff-Appellee, v. *James J. Hoey,* Collector of Internal Revenue for the United States for the Second District of the State of New York, Defendant-Appellant"; to the end that said cause may be reviewed and determined by this Court as provided by law, that the determination of the United States Circuit Court of Appeals for the Second Circuit herein may be reversed, and that your petitioner may have such other and further relief as may be just.

MUNRO L. LYETH,
By: J. M. RICHARDSON LYETH,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the Circuit Court of Appeals for the Second Circuit by Circuit Judge Chase (R. 203-209) and the concurring opinion by Circuit Judge Augustus N. Hand (R. 210-212) are reported in Commerce Clearing House, 1938 Federal Tax Service, Volume 4, Section 9255. The opinion of District Judge Alfred C. Coxe (R. 179-187) is reported in 20 Fed. Supp. 619.

Jurisdiction

The order for mandate of the Circuit Court of Appeals was filed April 18, 1938 (R. 213). Jurisdiction is conferred upon this Court by Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statement of Facts

The statement of facts and questions presented appear in the petition for certiorari.

Specification of Errors to be Urged

The Circuit Court of Appeals erred:

(1) In holding that the property received by the petitioner from the executors of his grandmother's

estate was taxable income under the Sixteenth Amendment of the Constitution of the United States.

(2) In holding that such property was not exempt from taxation under Section 22(b)(3) of the Revenue Act of 1932 which exempts "The value of property acquired by gift, bequest, devise, or inheritance * * *".

(3) In holding that the compromise of the pending litigation constituted a sale or exchange of property.

(4) In holding that the compromise of the pending litigation, which if successfully prosecuted to judgment would not have been productive of income, rendered property received under that compromise taxable as income.

(5) In holding that the right to participate as an heir in the entire decedent's estate, which the petitioner gave up under the compromise agreement, was not acquired by inheritance.

(6) In holding that the right to participate as an heir in the entire decedent's estate, which the petitioner gave up under the compromise agreement, had no cost basis to the petitioner.

(7) In holding that the determination of the Federal courts, as to whether the property received by the petitioner was "acquired by * * * inheritance" within the meaning of the exemption provision of the applicable revenue act, is controlled by decisions of the Massachusetts state courts construing the state inheritance tax act.

Argument

I

The decision below is in conflict with the decision of the Circuit Court of Appeals for the Fourth Circuit in *Magruder* v. *Segebade*.

In *Magruder* v. *Segebade*, 94 Fed. (2d) 177 (C. C. A. 4, affirming D. C. Md.), the taxpayers were heirs at law or next of kin of the testator who had executed two wills, one dated in 1926 and the one offered for probate dated in 1933. The taxpayers filed a notice of caveat before the last will was submitted for probate. No caveat was filed, but before the last will was admitted to probate a compromise agreement was entered into between the taxpayers and the other legatees under the last will whereby the other legatees paid to the taxpayers the sum of $245,000 and the taxpayers agreed that their objections to the probate of the last will would be withdrawn, the last will would be admitted to probate and the estate would be distributed in accordance therewith. The Circuit Court of Appeals for the Fourth Circuit, affirming the decision of the District Court, decided that the amounts received by the taxpayers were not taxable income under the statute or under the Sixteenth Amendment of the Constitution.

In the present case the facts are substantially identical except that under the compromise agreement the heirs, including the petitioner, received part of the decedent's property in kind from the executors, pursuant to an order of the Probate Court, and not a cash payment from the residuary legatees. This distinction in the facts emphasizes the conflict between

the decisions because there is much stronger ground for holding in the present case that the property was received by way of inheritance.

The opinions of the two Circuit Courts of Appeals conflict on all of the basic questions involved:

(1) The Fourth Circuit held that the receipts of the taxpayers under the compromise of the will contest were not income within the meaning of the Sixteenth Amendment. The Second Circuit held they were income.

(2) The Fourth Circuit indicated that said receipts would be exempt from tax under the exemption granted by Section 22 (b) (3) of the applicable Revenue Act. The Second Circuit held they were not exempt.

(3) The Fourth Circuit refused to hold that the compromise was a sale or exchange within the meaning of the taxing statute. The Second Circuit held that the compromise was a sale or exchange.

(4) The Fourth Circuit held that the results of a compromise of rights, the proceeds of which are not taxable, do not become taxable because the compromise was brought about by an agreement not to litigate. The Second Circuit held that the results of the compromise were taxable.

The irreconcilable conflict between the two courts is shown in the following quotations from their opinions:

Magruder v. *Segebade* (C. C. A. 4):

> "The precise question involved here was considered in the case of *Lyeth* v. *Hoey*, 20 Fed. Supp. 619, where the amount received by the compromise of a contested will was involved. Judge Coxe, in a well considered opinion, reached

the same conclusion as was reached here by the court below" (p. 178).

Lyeth v. *Hoey* (C. C. A. 2):

> "He (the plaintiff) is supported in this position by *Magruder* v. *Segebade*, 94 Fed. (2) 177 (C. C. A. 4) which expressly followed the decision of the district court in the instant case. With due deference, we are unable to reach the same conclusion * * *" (R. 208).

II

Many important cases are pending in the Bureau of Internal Revenue, the Board of Tax Appeals and the Courts involving the question decided in this case and in *Magruder* v. *Segebade*.

The decision of the court below establishes the principle that a claim which if successfully prosecuted to judgment would not be productive of taxable income, produces taxable income if it is compromised. Petitioner's counsel have received letters from attorneys for taxpayers in many cases involving this question, which are pending in the Bureau of Internal Revenue, the Board of Tax Appeals and the courts. A list of such cases is set forth in Appendix A. Many of these cases are being held in abeyance awaiting decision in this case.

There are six other cases involving income tax deficiencies against the other heirs of Mary B. Longyear. The total deficiencies against the heirs, including the petitioner, approximate $675,000, excluding interest. A list of these cases is also included in Appendix A.

III

The decision below will impose income tax liability upon parties to every compromise of a disputed claim of a capital nature.

The effect of the decision below is not limited to compromises of will contests. Compromises of claims to recover income will not be affected because the avails would be taxable whether the claim were prosecuted to judgment or compromised. However, every compromise of a claim of a capital nature will come within the purview of the decision, including claims for death or personal injuries, damage to property, defamation of character, seduction, alimony, and all claims which if successfully prosecuted to judgment would not produce taxable income. Few litigants of such claims will dare to compromise because of the hazard of incurring huge income taxes. Thus, if the decision below is not reversed, the well-established public policy of the courts to encourage compromises and reduce litigation will largely disappear.

Judge A. N. Hand, in the concurring opinion below held that petitioner acquired the right to contest the will by inheritance, but that he failed to establish that his chance of success was worth the amount received upon the compromise (R. 211). Judge Hand said:

> "That many considerations other than the weighing of strict legal rights dictate the settlement of will contests is notorious. If it had been, or could have been shown what the rights of the next of kin to contest the will were worth, I am inclined to think that no taxable gain could have been assessed unless the $141,484.03 proved to be greater than that worth."

It seems apparent that to satisfy Judge Hand's requirement the petitioner must introduce evidence of his grandmother's lack of testamentary capacity and undue influence and try the will contest in this law suit. If this theory is sound, litigants who compromise law suits in the expectation of saving the time and expense of litigation will be disappointed because they may have to try out the merits of the controversy with the Commissioner of Internal Revenue in an income tax case, in order to establish that their chance of success was at least as valuable as the amount received under the compromise.

The far-reaching effect of the decision in this case will be to impose a probable income tax liability upon parties to every compromise of a disputed claim of a capital nature. It will compel the litigation which the compromise was intended to avoid.

Conclusion.

In order that the conflict of the decision below with the decision of the Circuit Court of Appeals for the Fourth Circuit may be resolved and in order that the important question involved in the administration of the tax laws may be settled by this Court, it is submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

J. M. Richardson Lyeth,
Will R. Gregg,
Allin H. Pierce,
Counsel for Petitioner.

May, 1938.

Appendix A.

Pending Cases Involving the Question Decided in Lyeth v. Hoey

The following are the cases involving deficiencies in income taxes of the other heirs of Mary B. Longyear:

Case	Pending	Approximate Amount of Tax
John M. Longyear, Jr.	B.T.A. No. 87033	$142,649.54
Abby B. Roberts	B.T.A. No. 87000	141,755.40
Helen L. Paul	B.T.A. No. 86999	139,603.52
Robert D. Longyear (1933)	B.T.A. No. 87003	137,793.34
(1932)	U. S. District Court, Massachusetts	57.28
J. M. Richardson Lyeth, Jr.	Tax paid and claim for refund disallowed. Suit must be started before November, 1938, probably in Court of Claims	56,411.50

The following are other pending cases involving the question whether a claim which if successfully prosecuted to judgment would not be productive of taxable income, produces taxable income if it is compromised:

Case	Pending	Approximate Amount of Tax
Inez Renfro Allen	B.T.A. No. 92579	$107,260.70
Beatrice Andrews and others	Bureau of Internal Revenue	23,811.35
Albert J. Hall & Estate of Ada A. Hall	B.T.A. No. 92993	122,309.83
Fannie May Herrscher	B.T.A. No. 89452	121,209.25
Charlotte Keller	B.T.A. No. 93026	100,452.61
Grace B. Macquarrie	B.T.A. No. 85102	283,560.00
Rosa Dew Stansbury	B.T.A. No. 85103	283,810.79

Case	Pending	Approximate Amount of Tax
Stuart J. Rackham	B.T.A. No. 92772	50,176.66
Harry G. Rackham	B.T.A. No. 92773	59,396.21
Avery M. Rackham	B.T.A. No. 92774	59,196.88
Helen R. Clark	B.T.A. No. 93023	52,111.25
Leicester Schutte	Bureau of Internal Revenue	878.07
	New York State Tax Commission—claim for refund of income tax denied	701.80
Alexandra Gardiner Creel	Bureau of Internal Revenue	124,133.00
Robert David L. Gardiner	Bureau of Internal Revenue	upwards of 100,000.00